Statement of Investment Principles – British Steel Pension Scheme

A Introduction

1. This document is the Statement of Investment Principles ('SIP') made by the Trustee of the British Steel Pension Scheme (the 'Scheme') in accordance with the requirements of Section 35 of the Pensions Act 1995 (as amended by the Pensions Act 2004 and regulations made under it) ('the Pensions Act'). Before adopting this SIP, the Trustee formally consulted with the Sponsoring Employer.

2. The Trustee will review this SIP at least every three years, or without delay following any significant change in investment strategy.

3. The Scheme operates for the exclusive purpose of providing retirement benefits to eligible participants and beneficiaries ("members").

4. The powers of the Trustee to determine the manner in which assets of the Scheme are to be invested from time to time are set out in the trust deed governing the Scheme. The policies in this SIP are intended to be consistent with, but are subject to, the proper exercise of those powers.

5. The Trustee receives written advice that the Scheme's investments are satisfactory for the purpose of satisfying Section 36 of the Pensions Act either from its Investment Consultant or the Independent Property Advisor, as appropriate.

B Trustee objectives

6. The Trustee's objective is to manage the Scheme so that members receive their benefits as and when they fall due, without needing contributions from the Employer. The assets of the Scheme, which collectively are referred to as the 'Fund', are held by the Trustee for this purpose.

7. The long term investment objective of the Fund is to provide a high level of security of pension benefits in a cost effective manner, taking into account the risks to which the Scheme is exposed, as set out in section E. Ultimately, the Trustee expects that this objective will be satisfied by securing the Scheme's liabilities via the insurance market.

C Investment strategy

8. The over-riding principle is to acquire a portfolio of assets, the majority of which offer well-defined, low risk cashflows that in aggregate provide a good match to the benefit payments in any given year. Some of the Fund's assets will, however, be held for the purpose of enhancing return. In seeking to accomplish the long term investment objective, there are seven major factors that govern the investment strategy of the Fund:

    - The projected amounts of benefits that are expected to be payable each year into the future.
    - The extent to which the Scheme's liabilities are linked to inflation.
    - The maturity of the Scheme, as it determines the requirement to manage the reinvestment of the asset portfolio.
    - The nature and extent of unhedged risks.
    - The extent to which risks are likely to be covered by reserves in the Fund or underwritten through the covenant offered by the Employer.
    - A desire to diversify its risk exposures and to manage its investments efficiently, and
    - An assessment of the risk within the Fund versus the expected cost of securing the liabilities with an insurer.

9. The Trustee has received advice from its Investment Consultant to determine an appropriate investment strategy for the Fund. Around 60% of the Fund is currently invested in buy-in insurance policies. The remaining assets, the 'non-insured assets', will be invested in accordance with the asset allocation ranges set out in Appendix A.

10. The expected return on a portfolio invested in line with the Fund's assets is used as a reference point for determining a suitably prudent discount rate under the Scheme's Statement of Funding Principles. As at 31 March 2021, the effective date of the most recent Actuarial valuation, the expected return was approximately gilts +0.85% pa, based on the portfolio in place at that time.

11. While the Trustee's objective is to hold assets that will generate cash flows at least sufficient to meet liabilities, it also expects that the exposure to interest rate and inflation risk, as well as the sensitivity to changes in credit spreads and swap spreads, will be carefully managed through the Fund, in order to maintain a level of hedging consistent with the targets and ranges set out in Appendix A.

12. Derivatives will only be used in a controlled manner to facilitate the timely implementation of significant asset allocation moves, for the purposes of efficient portfolio management, to reduce risk or to facilitate closer asset/liability management, for example through interest rate and inflation hedging.

13. Sale and repurchase transactions (known as "repo transactions") are permitted for the purpose of managing interest rate and inflation risk. Use of repo and reverse repo transactions are also permitted for cash and/or collateral management purposes.

14. It is intended that the non-insured assets of the Fund will be constituted as a series of notional sub–portfolios as set out below, namely:

    - Maturity Property.
    - Global Sub-Investment Grade credit.
    - Private credit.
    - Global Credit Buy and Maintain
    - Liability Hedging Portfolio
    - Alternatives Portfolio.

15. The investment guidelines that cover intended allocations and credit criteria for these sub-funds (where relevant) are set out in the Investment Management Agreement (IMA) in place with the investment manager (the ‘Manager’).

16. The Trustee's policy is that there will be sufficient investments in liquid or readily realisable assets to meet cashflow requirements as they arise in foreseeable circumstances so that the realisation of assets will not disrupt the Fund's overall investments, where possible. The Fund will hold assets in cash and other money market instruments from time to time as may be deemed appropriate for short-term, non-strategic reasons, e.g. cash income received and not yet reinvested or held to be paid out shortly to pensioners. The Fund may also hold cash and cash equivalents for collateral management purposes.

17. The Trustee will not borrow money for any purpose, except by way of an overdraft with its custodian or a duly appointed sub-custodian for the purposes of meeting settlement or redemption mismatches on a short term basis. (For the avoidance of doubt, this does not preclude the use of repos for hedging purposes or for cash and/or collateral management.)

D Fund Managers

18. The Trustee will set general investment policy and will delegate the responsibility for day to day investment decisions as required by law.

19. The Trustee has appointed Legal and General Investment Management (LGIM) to manage the Fund’s non-insured assets. The appointment is ongoing and does not have an expected or minimum duration. It has also entered into a series of buy-in insurance policies with Legal and General Assurance Society (LGAS).

20. The mandates set out in LGIM’s IMA ensure that the decisions taken by LGIM are consistent with the Trustee’s longer term objectives and the policies set out in this Statement. They also encourage the active ownership of the Scheme’s assets by LGIM. The LGAS buy-in policies are, by design, aligned with the Trustee’s objective of delivering the Scheme’s liabiltiies.

21. The Trustee’s expectation is that the Fund undertakes all investments with a view to them being long term investments, and only when circumstances change materially, or long term objectives are achieved in a shorter space of time, will consideration be given to realising assets on a shorter time scale. The investment objectives and mandates that have been given to LGIM are consistent with operating with a longer term horizon.

22. The Trustee will maintain processes to ensure that performance of LGIM is assessed on a regular basis against measurable objectives consistent with the achievement of the Fund's long term objectives, and an acceptable level of risk. The Trustee will monitor investment performance at least quarterly, although with a focus on longer term outcomes.

23. LGIM's remuneration is based on an ad valorem fee covering the total assets under management. The Trustee has received advice from its Investment Consultant confirming the appropriateness of the fee charged.

24. As part of its monitoring of LGIM, the Trustee will, at least annually, monitor the level of turnover within the Fund, compare this with their expectations for the level of turnover given the nature of the Fund's investment arrangements and monitor the resulting transaction costs.

25. The Trustee recognises an investment's financial success is influenced by a wide range of factors including environmental, social and governance (ESG) issues (including climate change) and stewardship. The extent to which ESG issues (including climate change) may have an impact on the portfolio will be taken into account by LGIM when making day-to-day decisions about the investment of the Fund.

26. The Trustee recognises that effective stewardship (including the exercise of voting rights and engagement) can protect and enhance the value of investments. The Trustee's policy is to delegate responsibility for the exercising of rights (including voting rights) attaching to investments to LGIM and to encourage LGIM to exercise those rights. Rights attached to investments, including voting rights, will be exercised for the benefit of the Fund. Given the Fund's investment strategy, the exposure to investments which have such rights are expected to be very limited.

27. With regards to engagement activity, the Trustee recognises that there are a wide range of issues which can influence the operation and performance of individual investments. The Trustee has identified Climate Risk as a key risk for the Scheme, and as such expects this issue to be prioritised by LGIM when engaging on the Trustee's behalf. Aside from Climate Risk, the Trustee's expectation is that LGIM will determine the other issues on which it will engage on a case by case basis, based on its assessment of what will have the greatest impact on maximising the long term sustainable return from the investments.

28. The Trustee will engage with LGIM on a regular basis, and at least annually, to understand how financially material considerations have been taken into account in the management of the Fund, and how their responsibilities with regards to voting and engagement have been discharged.

29. At present, the Trustee does not explicitly take account of non-financial matters in Fund design or strategy but may consider reflecting specific non-financial considerations in the future.

E Risks and regulation

30. The Trustee has developed a detailed Integrated Risk Management policy and monitoring framework to ensure the risks to which the Fund is exposed are appropriately managed. A summary of the key risks and how they are measured and managed is set out below:

    — Credit risk

- is measured by monitoring defaults of and the credit rating of assets held in the portfolio.

- is managed through diversification, a reserve in the funding level and cash flow projections, the Manager's credit screening processes, and limitations on the proportions of assets that can be held by credit rating.

— Longevity risk

- is measured through analysis carried out by the Scheme Actuary and embedded in cash flow projections that are used to determine the liability benchmark against which the Fund is managed.

- is managed through a reserve in the funding level and cash flow projections, and partly by insuring a proportion of the liabilities.

— Deficit risk:

- is measured through a qualitative and quantitative assessment of the expected development of the liabilities relative to the current and alternative investment policies.

- is managed through assessing the progress of the liabilities relative to the selected investment policy.

— Manager risk:

- is measured by the potential deviation of the return on the Fund's assets relative to expectations, as a result of the Manager's implementation of the investment strategy.

- is managed by setting asset allocation ranges within which the Manager must operate and by setting guidelines for the underlying portfolios which make up the Manager's mandate.

— Liquidity risk:

- is measured by the level of cashflow required by the Fund over a specified period.

- is managed by the Fund's administrators assessing the Fund's likely cashflow needs and by the Manager holding sufficient assets of appropriate liquidity in order to limit the impact of the cashflow requirements on the investment policy.

— Currency risk:

- is measured by the level of exposure to non-Sterling denominated assets.

- is managed through consideration of both currency and investment aspects when gaining exposure to overseas assets.

- currency hedging strategies are employed to manage this risk either strategically as part of the relevant mandate or at the Manager's discretion.

— Interest rate and inflation risk:

- is measured by comparing the likely movement in the Scheme's liabilities and assets due to movements in inflation and interest rates.

- is managed by holding a portfolio of matching assets (insurance policies, physical bonds and/or other real assets) and derivatives that enable the Fund to better match movements in the value of the liabilities due to changes in inflation and interest rates.

- The Trustee recognises that not all of the Scheme's liability indexation can be precisely hedged via market instruments. The Scheme Actuary will project the liabilities by using assumptions on CPI/RPI differences and CPI volatility that will allow the Manager to hedge the expected inflation exposure with market instruments. These assumptions will be re-examined regularly and any resultant changes to expected cash flows will be communicated to the Manager.

— Climate risk

- is measured by assessing the potential impact that adverse climate scenarios could have on the Scheme's assets and liabilities and hence ability to achieve its longer term objectives.

- is managed by monitoring a range of metrics related to climate risk, by setting a target to reduce the Fund's carbon emissions intensity over time and by embedding climate risk management into the IMA in place with the Manager.

— Counterparty risk

- is measured as the exposure to counterparties to a transaction (such as when using derivatives or entering 'buy-in' insurance contracts) and represents the risk that the counterparty defaults on its obligations resulting in a loss to the Scheme.

- in relation to derivatives, the risk is managed as outlined under 'Derivatives risk' below. In relation to buy-in contracts, transactions may be collateralised, if deemed appropriate.

— Political risk:

- is measured by the level of concentration of any one market leading to the risk of an adverse influence on investment values arising from political intervention.

- is managed by regular reviews of the actual investments relative to policy and through the level of diversification within the existing policy.

— Employer risk:

- is measured by receiving regular financial updates from the Employer and periodic independent covenant assessments.

— Derivatives risk

- Derivatives are used only in the manner set out in section C.

- Counterparty risk – this risk is mitigated through collateral management, diversifying exposure across counterparties, and the use of robust derivatives documentation.

- Basis risk – the returns from backing assets used to meet the payable leg of a derivative contract may not match exactly. This risk is addressed through the investment policy adopted by the Trustee for the supporting assets and the Manager's asset management capabilities.

- Liability risk – pension liabilities can only be estimated and there is a risk of divergence between the performance of the derivatives and the actual value of the liabilities (for example, due to changes in assumptions or demographics, and the lack of any investments that give CPI protection). This risk is mitigated by updating the liability hedging benchmark at appropriate regular intervals.

- Roll risk – derivatives are chosen in order to minimise the risk of repos maturing at the same time and having to enter new contracts on then prevailing terms.

- Legal and operational risk – the successful operation of derivatives depends on the various legal documents governing the derivative contracts and the correct completion of some operational tasks. The Trustee takes appropriate advice when putting in place legal documents, reviewing legal documents already in place and appointing and monitoring providers capable of carrying out the required operational tasks.

- The Trustee is also aware of the risks relating to the initial terms of entry in derivative contracts (for example, purchasing the contracts at a competitive price) and the valuation of the derivatives on an ongoing basis.

31. The Trustee exercises its powers of investment, and any managers to whom discretion has been delegated, will exercise their discretion in accordance with Regulation 4 of the Occupational Pension Schemes 2005 Investment Regulations (as amended from time to time).

32. Inadvertent breaches of guidelines may happen including as a result of market movements and will be reported to the Trustee. The aim in such cases will be to bring back the Fund within the guidelines within a reasonable period by asset purchases and/or disposals but without fire sales of assets.

This Statement of Investment Principles, dated has been signed on behalf of the Trustee of the British Steel Pension Scheme

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Appendix A

Strategic Asset Allocation – non-insured assets

Asset Class	Asset Allocation Ranges	
	Lower	Upper
Maturity Property*	0%	n/a
Global Sub-Investment Grade credit	0%	7%
Private credit**	0%	7%
Global Credit Buy & Maintain	30%	80%
Liability Hedging Portfolio	10%	45%

* The Maturity Property portfolio is being run down and no new investments will be made within this portfolio.
** This allocation includes the interest rate and currency hedging portfolio associated with the Private credit mandate.
Note that the Alternatives Portfolio is a portfolio containing legacy illiquid investments, such as private equity and infrastructure vehicles, some property investments as well as a small number of illiquid equity holdings. These assets are in run-off or are to be sold when appropriate opportunities arise, and this portfolio is therefore excluded from the overall asset allocation guidelines shown above. For the avoidance of doubt, LGIM may not make any new purchases of any such assets falling within the Alternatives Portfolio, other than proceeds from the disposal of assets within the Alternatives Portfolio will be invested in a cash fund within that portfolio.

For the avoidance of doubt, LGIM may not make any new purchases in the form of equity securities.

Hedging policy

Hedge ratio as a % of non-insured buy-in liabilities	Lower	Target	Upper
Interest rate exposure*	89%	93%	110%
Inflation exposure*	89%	93%	110%

*The hedging policy is currently being reviewed following the completion of the lastest buy-in transaction.

The hedging strategy for credit spread and swap spread sensitivities is also currently being considered. Target hedge ratios and ranges for these sensitivities will be included in the table above when the SIP is next updated.